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Bilateral investment treaties

Tarcisio Gazzini

I. Introduction

A variety of legal instruments, belonging to different legal systems, contribute to the legal protection of foreign investment. Amongst them, bilateral investment treaties (BITs) have played and continue to play a prominent role with regard to both the creation of a stable and predictable normative framework and the settlement of related disputes.¹

This chapter is intended to offer an overview of the main – and in many respects unique – features of BITs. It first describes the disadvantages, advantages and potential of the largely bilateral framework for the protection of foreign investment (Part II). It then examines the special position foreign investors enjoy under these treaties, both in substantive and procedural terms, keeping in mind that foreign investors are manifestly the main beneficiaries of these treaties, yet formally extraneous to the process leading to their conclusion, modification and termination (Part III). Part IV considers how BITs strike a balance between the sovereign prerogatives of States parties and the need to protect the legitimate expectations that these treaties create for foreign investors. Parts V further elaborates on this balancing exercise from the standpoint of the law of treaties. Part VI and VII are consecrated, respectively, to some issues of interpretation of BITs and the settlement of disputes arising from these treaties. Part VIII touches upon the interaction between BITs and State contracts, including the so-called umbrella clauses. A full discussion of the relationship between BITs and contracts can be found in Chapter VII of this book.²

¹ On foreign investment treaties, see in particular: R. Dolzer, M. Stevens, *Bilateral Investment Treaties* (The Hague: Nijhoff, 1995), G. Sacerdoti, 'Bilateral Treaties and Multilateral Instruments on Investment Protection', *Recueil des Cours* 269 (1997) 251; K.J. Vandeveld, *Bilateral Investment Treaties. History, Policy, and Interpretation* (Oxford: OUP, 2010); J.W. Salacuse, *The Law of Investment Treaties* (Oxford: OUP, 2010); G. Van Harten, 'Five Justifications for Investment Treaties: A Critical Discussion', *Trade Law & Development* 2 (2010) 1.

² On the sources of foreign investment law, see, in particular: P. Juillard, 'L'évolution des sources du droit des investissements', *Recueil des Cours* 250 (1994) 9, M. Hirsh, 'Sources of International Investment Treaties', Hebrew University of Jerusalem, Research Paper 05-11, July 2011, available at www.ssrn.com/abstract=1892564.

II. A largely bilateral framework

There exists no multilateral treaty on foreign investment comparable in terms of participation to multilateral trade agreements. Attempts to conclude such a treaty have failed and there is no evidence that any such treaty will be concluded in the near future. The unsuccessful negotiations of the Multilateral Agreement on Investment within the OECD³ and the clumsy remake within the WTO⁴ have demonstrated that disagreement on key issues remains an insurmountable obstacle for any meaningful multilateral agreement.

As a matter of treaty law, therefore, foreign investments are currently protected by a complex web of bilateral investment treaties (BITs), specific provisions, chapters, or legal documents contained in or attached to a large number of bilateral or plurilateral Regional Trade Agreements (RTAs),⁵ as well as the Energy Charter Treaty, a multilateral agreement in the energy sector.⁶

Regional economic integration may be a vehicle to multilateralize the legal protection of foreign investment. It can even offer a third way, alternative to a multilateral treaty on investment and a network of BITs.⁷ Such an alternative may also strike a balance of the respective advantages of multilateralism and bilateralism. All these issues are discussed

³ OSCE, Multilateral Agreement on Investment Draft Consolidated Text and Commentary, 22 April 1998, respectively DAF/MAI(98)7/REVI and DAF/MAI(98)8/REVI. See also: UNCTAD, *Lessons from the MAI, New York and Geneva*, 1999, UNCTAD/ITE/IIT/MISC. 22; P.T. Muchlinski, 'The Rise and Fall of the Multilateral Agreement on Investment: Where Now?', *International Lawyer* 34 (2000): 1033.

⁴ See Decision of the WTO General Council, 1 August 2004, WT/L/579, 2 August 2004.

⁵ See, in particular, North America Free Trade Agreement (NAFTA, Chapter XI), European Free Trade Area (EFTA, Chapter IX), Central America Free Trade Area - Dominican Republic - (CAFTA-DR, Chapter X), Common Market for Eastern and Southern Africa (COMESA, Chapter XXVI), Association of East Asian Nations (ASEAN), and Southern Common Market (Mercosur).

⁶ On the Energy Charter Treaty, see, in particular: T.W. Wälde, *The Energy Charter Treaty. An East-West Gateway for Investment Trade* (The Hague: Kluwer, 1996); T.W. Wälde, 'Energy Charter Treaty-based Investment Arbitration', *JWI&T* 5 (2004) 373; C. Ribeiro (ed.), *Investment Arbitration and the Energy Charter Treaty*, (Huntington: Juris Publishing, 2006); G. Coop, C. Ribeiro (eds.), *Investment Protection and The Energy Charter Treaty* (Huntington: Juris Publishing, 2008).

⁷ On the role the European Union plays after the entry into force of the Lisbon Treaty, see, in particular: M. Bungenberg, J. Griebel, S. Hindelang (eds.), *International Investment Law and EU Law*, *European Yearbook of International Economic Law* (2011) Special Issue; A. Dimopoulos, *EU Foreign Investment Law* (Oxford: OUP, forthcoming).

in Chapter II of this book alongside with the question of the alleged incompatibility of BITs with the MFN clause embodied in Article II:1 GATS.⁸

On the latter question, suffice here to mention that the concern expressed in literature on the possible violations of MFN obligation under GATS may be countered by arguing that the conclusion by virtually all States of a large number of BITs, coupled with the acquiescence by those States not involved in such practice, may amount to subsequent practice for the purpose of interpreting or even modifying Article II:1 GATS.⁹

For the time being, however, the legal protection of foreign investment remains to a large extent bilateral in character with a wealth of about 2,800 BITs concluded since 1959 with a significant acceleration in the last two decades.¹⁰ Although the figure is certainly impressive, its quantitative importance should not be exaggerated for two reasons. On the one hand, these treaties cover roughly 14% of the bilateral relationship between states.¹¹ On the other hand, it must be noted that the Energy Charter Treaty alone accounts for the equivalent of more than 1,000 bilateral agreements.

⁸ See, in particular, F. Ortino, 'The Principle of Non-discrimination and its Exceptions in GATS: Selected legal Issues', in M. Andenas, K. Alexander (eds.) *The World Trade Organization and Trade in Services* (Leiden: Nijhof, 2008): 173.

⁹ From this perspective, the conclusion of a large number of BITs may be treated as "a discernable pattern implying the agreement of the parties regarding its interpretation", *Japan-Taxes on Alcoholic Beverages*, WT/DS11/AB/R [1996] 1 DSR 106; *Chile-Price Band System and Safeguard Measures Relating to Certain Agricultural Products*, WT/DS207/AB/R, para 214; *EC-Customs Classification of Certain Computer Equipment*, WT/DS62/AB/R, para 90; *US-Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WT/DS285/AB/R, para 190. See also the views expressed by the International Law Commission, *Yearbook ILC* 18 (1966-II) 222. On acquiescence, see *EC-Customs Classification of Frozen Boneless Chicken Cuts*, WT/DS269/AB/R, para 272. On the modification of treaties through subsequent practice, see, in particular, *Air Transport Services Agreement Arbitration*, U.S. v. France, 22 December 1963, in *International Law Reports* 38 (1969) 182, p. 249; *Case Concerning the Temple of Preah Vihear*, I.C.J. Reports 1962, p. 6.

¹⁰ According to UNCTAD, at the end of 2010, States had concluded 2,807 BITs, *World Investment Report 2011* (UNCTAD/WIR/2011), p. 100, at <http://www.unctad-docs.org/files/UNCTAD-WIR2011-Full-en.pdf>. For a detailed treatment of the historical evolution of BITs, see K.J. Vandevelde, above n. 1, Chapter 2.

¹¹ To cover the totality of bilateral relationships between n States it is necessary to conclude a number of bilateral treaties equivalent to: $n(n - 1) / 2$, see E. Giraud, 'Modification et terminaison des traités collectifs', *Annuaire Institut de droit international* 49 (1961) 1, p. 16 ff.

Undoubtedly a multilateral treaty has many advantages. First and foremost, it establishes a single legal framework and ensures the greatest simplicity, coherence and uniformity with regard to the rules applicable to the parties. A multilateral treaty, however, does not need to be unduly rigid and contracting parties may accommodate their specific needs through variable geometry, protocols, reservations, opting out mechanisms, optional declarations or in any other manner permitted under the law of treaties. While introducing in the system the necessary degree of flexibility, these devices should not be used excessively – or abused – lest of undermining the integrity of the treaty.

Additionally, multilateral treaties are expected to generate coherent State practice. This is facilitated by the existence of a single set of rules applicable by the entities responsible to implement the treaty within the jurisdictions of all parties to the treaties. State practice can thus consolidate a stable and predictable legal framework, clarify the meaning of the rules contained in the treaty, and possibly contribute to the crystallization or development of customary international law.

From the standpoint of the settlement of disputes, furthermore, the interpretation and application by national courts and investment arbitral tribunals of the same treaty will in all probability reduce the legal uncertainty surrounding investment-related disputes and progressively develop a consistent body of jurisprudence tribunals could comfortably rely upon. The risk of conflicting decisions, being inherent in the sovereign character of international investment tribunals, however, cannot be eliminated simply by adopting a multilateral treaty.

While recognizing all these advantages of multilateral treaties, nevertheless, one should not be unconditionally hostile to BITs as bilateralism is not necessarily less effective or less adequate than multilateralism and in turn offers its own advantages.

In the first place, there is no compelling economic evidence that a multilateral treaty would have a significantly bigger positive impact on the flow of foreign investment than a network of BITs. It must be noted in this respect that recent empirical studies point to a stimulating effect of BITs on the flow of investment towards the concerned States.¹²

¹² See, for instance: E. Neumayer, L. Spess, 'Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries?', *World Development* (2005): 1567; K. Gallagher, M.B.L. Birch, 'Do Investment Agreement attract Investment?', *Journal of World Investment & Trade* 7 (2006): 961; P. Egger, V. Merlo, 'The Impact of Bilateral Investment Treaties on FDI Dynamics', *World Economics* 30 (2007): 1536; J.B. Yackee, 'Conceptual Difficulties in the Empirical Study of Bilateral Investment Treaties',

Apart from the difficulties in determining the link between the conclusion of BITs and the increase in foreign investment, however, it must not be neglected that countries bound by a handle of BITs or no BITs at all - such as Japan or Brazil - have managed to attract remarkable flows of foreign investment.

Second, the current legal framework, however fragmented, works quite well. It is in continuous expansion, even though the conclusion of new BITs has slowed down in the last few years. Additionally, the accuracy, level of sophistication and coherence of the current legal framework progressively improves due the renegotiation of BITs, the elaboration of new model BITs, and the development of a largely consistent body of arbitral decisions.

Third, the framework has a significant potential for improvement with regard to both substantive and procedural rules (for instance, through the inclusion, respectively, of provisions on the protection of human rights and the environment, and of clauses on consolidation¹³ and judicial review¹⁴).

Forth, the most-favored-nation treatment clause (MFN) contained in the overwhelming majority of modern BITs upgrades the legal protection enjoyed by foreign investors, although the clause works in quite a different manner compared with MFN clauses contained in international trade agreements.¹⁵ Described as a “potent ratchet”,¹⁶ this

Brooklyn Journal International Law 33 (2008): 405; J. Tobin, S. Rose-Ackerman, ‘When BITs have some Bite’, in R.A. Alford, C. Rogers (eds.), *The Future of Investment Arbitration* (Oxford: OUP, 2009): 131.

¹³ See, for instance: Article 1126 NAFTA; Article 33, 2004 United States BIT Model; Article 32, 2004 Canada BIT Model, at <http://ita.law.uvic.ca/documents/Canadian2004-FIPA-model-en.pdf>; Article 37 ASEAN Comprehensive Investment Agreement, 26 February 2009, at <http://www.aseansec.org/22218.htm>; Article 10.24, FTA United States – Mexico, 15-Jun-2004, at <http://rtais.wto.org/UI/CRShowRTAIDCard.aspx?enc=Q6mlxSufgPIwin1qUYY1HY5jXkJ6LqSsfoOPqS+O+Jk=>; Article 10.26 FTA Canada – Chile; Article 101, FTA Chile – Japan, 27-Mar-2007 at <http://www.mofa.go.jp/region/latin/chile/joint0703/agreement.pdf>. For a case of consolidation, see *Pan American Energy LLC and BP Argentina Exploration Company v. Argentina*, ICSID ARB/03/13, Decision on Preliminary Objections, 27 July 2006.

¹⁴ See, for instance, Annex D (Possibility of a Bilateral Appellate Mechanism), 2004 United States BIT Model; Annex 10 D ((Possibility of a Bilateral Appellate Mechanism), FTA United States – Morocco.

¹⁵ See also Article 1103 NAFTA and Article 40 (2) of the EFTA/Singapore Agreement. See also UNCTAD, ‘Most-Favoured-Nation Treatment’, New York – Geneva, 1999, UNCTAD/ITE/IIT/10 (Vol. III), at <http://www.unctad.org/en/docs/psiteiitd10v3.en.pdf>; OECD, ‘Most-Favoured-Nation Treatment in International Investment Law’, Working Papers on International Investment, November 2004/2, at

contingent standard enables foreign investors to invoke the better treatment accorded by the host State to investors of any third State,¹⁷ provided that there is correspondence as to the subject matter between the two treaties (*ejusdem generis* principle).¹⁸

Finally, for decades BIT were concluded between developed countries and developing countries, as foreign investment essentially flowed from the former to the latter. Nowadays, investing abroad is not any more a privilege of developed countries and BITs have a truly universal dimension as a large number of them are concluded between emerging or developing countries. Since the content of BITs is to a large extent similar or identical, at least with regard to the main substantive rules, these treaties have significantly influenced the customary rules in this field.¹⁹ This process has contributed to increase the coherence and uniformity of international investment law.²⁰

Last but not least, three main specific advantages of bilateralism deserve to be mentioned.

First, the flexibility of a bilateral framework permits States to tailor their commitments in accordance with their specific needs.²¹ Indeed, BITs contain a variety of provisions,

<http://www.oecd.org/dataoecd/21/37/33773085.pdf>. In literature, see: S. Fietta, 'Most Favoured Nation Treatment and Dispute Resolution Under Bilateral Investment Treaties: A Turning Point?', *IALR* 4 (2005) 131; P. Acconci, 'Most-Favoured-Nation Treatment and International Law on Foreign Investment', in P. Muchlinski, F. Ortino, C. Schreuer (eds.), *The Oxford Handbook of International Investment Law* (Oxford University Press, 2008), p. 363; A. Ziegler, 'Most-Favoured-Nation (MFN) Treatment', in A. Reinisch (ed.), *Standards of Investment Protection* (Oxford: Oxford University Press, 2008), p. 59; S.W. Schill, *The Multilateralization of International Investment Law* (Cambridge: CUP, 2009), Chapter IV.

¹⁶ C. McLachlan, L. Shore, M. Weiniger, *International Investment Arbitration* (Oxford: OUP, 2007), p. 254.

¹⁷ As pointed out in *Siemens v. Argentina*, ICSID ARB/02/8, Jurisdiction, 3 August 2004, para 120, the clause "relates only to more favourable treatment".

¹⁸ *The Ambatielos Claim* (Greece, United Kingdom of Great Britain and Northern Ireland), Award, 6 March 1956, XII UNRIAA (1963), p. 83, at p. 107. See also *Maffezini v. Spain*, ICSID ARB/97/7, Award on Jurisdiction, 25 January 2000, para 48 ff.

¹⁹ See, for instance, *Mondev International Ltd. v. United States*, ICSID ARB(AF)/99/2 (NAFTA), Award, 11 October 2002, para. 43.

²⁰ For a thoroughly discussion, see S.W. Schill, above n. 15. See also S.M. Schwebel, 'The Influence of Bilateral Investment Treaties on Customary International Law', *American Society International Law Proceedings* 98 (2004) 27; J.H. Alvarez, 'A BIT on Custom', *N. Y. Univ. J. Int'l L. & Pol.* 42 (2010) 17.

²¹ As noted by K.C. Kennedy, 'A WTO Agreement on Investments: A Solution in Search of a Problem', *Univ. Pennsylvania J. Int'l Econ. L.* 24 (2003) 77, p. 183, "Bilateral investment agreements offer the flexibility that is not possible under a multilateral framework. BITs can be tailored to fit country-specific needs in a way that is not possible under a multilateral framework".

especially with regard to the definition of investment, the nationality of the investor, pre-establishment treatment, emergency clauses, and, perhaps more prominently, the settlement of disputes.

More than that, it is not uncommon that the provisions of the very same BIT do not apply in a symmetric way to both parties. This may occur with regard to substantive provisions, or, more frequently, the provisions on the settlement of disputes. According to Article II (1) of the BIT between United States and Argentina, for instance, each party is entitled to maintain or make exceptions to the national treatment obligation in the sectors indicated by each of them in the protocol. An example of asymmetric provisions related to the settlement of disputes can be found in Article 10 (2) of the BIT concluded between The Netherlands and China, according to which China may require Dutch investors to exhaust the domestic administrative review procedure before submitting the dispute to an international investment tribunal.²²

Second, the bilateral nature of these treaties facilitates their modification through protocols, amendments or subsequent practice. Contracting parties may thus alter their obligations in order to meet their evolving financial or economic needs or to keep the rules governing foreign investment in line with the evolution of international law, especially in relation to the protection of the environment, labour standards and human rights.

From this perspective, BITs were traditionally silent on the protection of the environment or contained only broad references to it in preambles. In the last few years, however, contracting parties to BITs have included with increasing frequency provisions on the protection of the environment.²³ These provisions are rather heterogeneous as far as their content is concerned and often drafted in general terms. Moreover, even when they impose sufficiently clear substantive obligations they normally do not fall within the scope of the arbitral clauses.²⁴ Nonetheless, it must be emphasized that the bilateral

²² See also Ad Article 11 (2) of the Protocol to the BIT concluded between China and Switzerland; Article 8 (2) of the BIT between China and Argentina.

²³ For a couple of example, see Article VII (4) BIT between Belgium-Luxemburg Economic Union and Colombia, Article 2 (3) BIT between the Russian Federation and Hungary; Article 7 (2) BIT between Canada and Peru. For a recent survey, see K. Gordon, J. Pohl, *Environmental Concerns in Investment Agreements: A Survey*, OECD Working Papers on International Investment, No. 2011/1, May 2011, at http://www.oecd-ilibrary.org/finance-and-investment/environmental-concerns-in-international-investment-agreements_5kg9mq7scrjh-en.

²⁴ See, for instance, Articles 12 (1), 24 (1) and 37 of the United States model BIT.

character of the framework allows for an incremental process which may be expected to lead in due time to the inclusion of these provisions on a large scale. Such a result may be difficult if not impossible to be achieved in the context of a multilateral treaty.

It is also worthwhile noting that some Free Trade Agreements (FTA) or agreements concluded between FTA and third States contain a so-called evolutionary clause whereby the parties undertook to review the legal protection of foreign investment, often through a Joint Committee, in order to bring it in line with further developments in international economic relations²⁵ or improve the internal legal framework regarding investments.²⁶

Third, the adoption of binding common interpretations, should the need arise to clarify the content of certain treaty provisions, is obviously much easier in the context of bilateral treaties than multilateral treaties. Certain BITs contain specific provisions for that purpose.²⁷ Argentina and Panama, for instance, exchanged diplomatic notes with an “interpretative declaration” of the MFN clause contained in the BIT they had concluded in 1996.²⁸

III. Nature of BITs

BITs squarely fall within the definition of treaty under Article 2 (1) (a) of the Vienna Convention on the Law of Treaties (VCLT) as they are international agreements concluded between States in written form and governed by international law. They normally pursue two main objectives. On the one hand, they aim at stimulating the flow of foreign investment and creating a stable and predictable legal environment for their management; on the other hand, they promote the economic development of the host State and the economic relations between the parties.²⁹ The two objectives are intimately related and mutually supportive.

²⁵ See, for instance, the agreement between the European Free Trade Association (EFTA) and Croatia, at <http://www.efta.int/content/legal-texts/third-country-relations/croatia/HR-FTA.pdf>.

²⁶ See, for instance, Article 33 of the Central European Free Trade Agreement (CEFTA), at <http://www.cefta2006.com/doc/CETA-Linkovi/Home/eng/CEFTA%202006%20ANNEX%201.pdf>.

²⁷ See, for instance, Article 17.2 BIT between the United Kingdom and Mexico. See also Article 30 (3) of the United States 2004 Model BIT.

²⁸ As referred to by the Tribunal in *National Grid plc v Argentina*, UNCITRAL, Decision on Jurisdiction, 20 June 2006, para 85.

²⁹ See, for instance, *Saluka Investments BV v. Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, para 300.

As a matter of fact, however, virtually all substantive rules contained in these treaties are meant to protect foreign investors who, although not formally party of the treaty, are clearly their main beneficiaries.³⁰ It is illustrative that certain BITs,³¹ alongside with the Energy Charter Treaty,³² in case of disputes between foreign investors and the host State provide access to international arbitral tribunals exclusively to the former.

It must also be noted that obligations imposed upon foreign investors by BITs, such as the obligation to act in good faith³³ or the obligations to comply with local laws and regulations,³⁴ are functional to the enjoyment by foreign investors themselves of the legal protection provided for by the treaties.

The manifestly asymmetrical nature of these treaties, with all obligations incumbent upon the host State and virtually all rights granted to the foreign investors, has often been criticized, especially from the human rights standpoint.³⁵ Such a feature is certainly not inherent in this kind of treaties, but rather a deliberate choice of the contracting parties. Nothing would prevent contracting parties from inserting in these treaties provisions imposing upon foreign investors or upon both foreign investors and the host state substantive obligations, including those related to the protection of human rights and labour or environment standards. The contracting parties could even agree on the settlement through arbitration of disputes concerning these obligations between nationals

³⁰ See, for instance, *American Manufacturing and Trading, Inc. v. Zaire*, ICSID ARB/93/1, Award, 21 February 1997, para 6.06.

³¹ See, for instance, Article 10 (3) BIT between China and The Netherlands; Article 8 (2) BIT between Switzerland and Ethiopia; Article 9 (2) BIT between Italy and Pakistan; Article 6 (2) BIT between Egypt and Nigeria.

³² Article 26 (1) of the Energy Charter Treaty provides for the settlement of disputes between a Contracting Party and a foreign investor “for alleged breach of an obligation of the former”.

³³ In *Phoenix Action, Ltd. v. Czech Republic*, ICSID ARB/06/5, Award, 15 April 2009, para 106, for instance, the Tribunal held that “[t]he protection of international investment arbitration cannot be granted if such protection would run contrary to the general principles of international law, among which the principle of good faith is of utmost importance”.

³⁴ See, for instance, *Inceysa Vallisoletana S.L. v. Republic of El Salvador*, ICSID ARB/03/26, Award, 2 August 2006, para 249.

³⁵ See, for instance, J.E. Alvarez, ‘Critical Theory and the North American Free Trade Agreement’s Chapter Eleven’, *Univ. Miami Inter-Am. Law Review* 28 (1996-7) 303, p. 308, who describes NAFTA investment chapter as “a human rights treaty for a special-interest group” and “a treaty that is effectively silent with respect of the rights of others, who may be affected by foreign direct investment flow”.

of a party and investors of another party or between those within the jurisdiction of a party and investors of another party.³⁶

The asymmetric nature of BITs is further amplified by more favorable provisions clauses often contained in BITs according to which the treaty does not derogate from any other rules of international law, including other investment treaties, as well as national legislation, to the extent the former are more favorable to the investor.³⁷

More than the unbalance of substantive provisions, however, what make these treaties truly remarkable is that the investor is allowed to vindicate violations of the obligations imposed by these treaties before the national tribunals of the host State and – with rare exceptions³⁸ – before international tribunals, normally without the exhaustion of domestic remedies being necessary.³⁹ The direct access to international tribunals has prompted a stimulating debate on the legal nature of the rights enjoyed by investors and the latter's status in international law.

The most enthusiastic position has been taken by the *Plama* Tribunal. It observed that Article 26 of the Energy Charter Treaty, which provides for the settlement of disputes between foreign investors and the host State, “is a very important feature of the ECT which is itself a very significant treaty for investors, marking another step in their transition from objects to subjects of international law”.⁴⁰

According to a more prudent and convincing approach, foreign investors can be seen as participants in international law, thus overcoming the sterile dichotomy between subjects

³⁶ T. Weiler, ‘Balancing Human Rights and Investor Protection: A New Approach for a Different Legal Order’, *Boston College Int. & Comp. Law Review* 27 (2004) 429, proposes some draft articles that could be inserted in investment treaties in order to recognize and make enforceable the investment-related human rights of nationals of the host State. In line with the scope of application of most human rights treaties, it may even be argued that these remedies should not be confined to nationals of the host State, but be available to those within its jurisdiction of the Host State, regardless to their nationality. At any rate, these remedies could be subjected to the exhaustion of domestic remedies.

³⁷ For an example, see Article 9 BIT between China and Switzerland.

³⁸ See below, note 96.

³⁹ Exhaustion of local remedies is rarely required in BITs. For an example see Article 13 (4) of the BIT between Australia and Poland. In literature, see M. Sornarajah, *The Settlement of Foreign Investment Disputes* (The Hague: Kluwer, 2000); C. McLachlan, L. Shore, M. Weiniger, above n. 16; Z. Douglas, *The International Law of Investment Claims* (Cambridge: CUP, 2009).

⁴⁰ *Plama Consortium Limited v. Bulgaria*, ICSID Case No. ARB/03/24, Jurisdiction, 8 February 2005, para 141 *in fine*.

and objects. The basic assumption behind this approach is that ‘there is no inherent reason why the individual should not be able directly to invoke international law and to be the beneficiary of international law’.⁴¹

Significantly, already in 1928, the Permanent Court of International Justice held that

it cannot be disputed that the very object of any international agreement, according to the intention of the contracting parties, may be the adoption of some definite rules creating individual rights and obligations and enforceable by the national courts.⁴²

The Court pointed out that the individual rights stemming from the treaty could be enforced before national tribunals, although this may require the adoption by the parties of the necessary national legal instruments.⁴³ The position of the Court nonetheless amounted to an important step in respect of the participation of individuals in international law.

That an international treaty can create rights in favour of individuals was reiterated in even clearer terms by the International Court of Justice in *LaGrand* with regard to Article 36 of the Vienna Convention on Consular Relations that creates individual rights which could be invoked in the ICJ by the national State of the person concerned.⁴⁴

In a subsequent case, the International Court of Justice clarified its position by observing that the individual rights protected under paragraph Article 36 of the Vienna Convention on Consular Relations must be asserted first before national tribunals. According to the

⁴¹ R. Higgins, *Problems & Process: International Law and How We Use It* (Oxford: Clarendon, 1994), p. 54. See also on the notion of individuals as participants in international dispute settlement and investment arbitration: E. De Brabandere, ‘Non-state actors in international dispute settlement: pragmatism in international law’ in J. d’Aspremont (ed.), *Participants in the International Legal System. Multiple Perspectives on Non-State Actors in International Law* (Abingdon: Routledge, 2011): 342-359; P. Dumberry, E. Labelle Eastaugh, ‘Non-State Actors in International Investment Law: The Legal Personality of Corporations and NGOs in the Context of Investor-State Arbitration’, *ibid.*, 360-371

⁴² *Jurisdiction of the Courts of Danzig*, Advisory Opinion, P.C.I.J., Ser. B, No. 15 (1928) p. 17-18.

⁴³ The Court also noted that Poland could not invoke the fact that the relevant treaty had not been incorporated into the Polish domestic legal system to escape from its international obligations (p. 26-7). On the necessity of a national legal instrument giving effect to the treaty within the jurisdiction of the parties, see one of the most influential members of the Permanent Court of International Justice, D. Anzilotti, *Cours de droit international public* (Paris: Sirey, 1929), p. 407 ff.

⁴⁴ *LaGrand* (Germany v. United States of America), Judgment, *I. C. J. Reports 2001*, p. 466, para 77. But see the separate opinion by Judge Shi, p. 518.

Court, only when local remedies have been exhausted the national State is entitled to espouse the individual claims of its nationals through diplomatic protection.⁴⁵

Yet, two different and independent legal relationships coexist. The first legal relationship, between the host State and the individual, allows the latter to bring a claim before the tribunals of the former. Once the domestic remedies have been exhausted, the State may “espouse” the individual claim and exercise diplomatic protection.⁴⁶ The second legal relationship, between the host State and the national State, enables the latter to directly react on the international plane and possibly file an application before the ICJ, assuming the latter can exercise its jurisdiction over the dispute. The same conduct by the host State may violate at once the rights of the individual and those of its national State, and therefore affect both legal relationships and trigger their respective remedies.

Against this background, investment treaties amount to a normative breakthrough as they normally pave the way to the direct access by foreign investors to international investment tribunals. It must be emphasized in this respect that Article 26 of the ICSID convention expressly excludes the requirement of exhaustion of local remedies, unless otherwise agreed by the parties in the relevant international treaty.

Two alternatives have been suggested to explain the legal position of the investor in international investment treaties and its relationship with both the host State and the home State:

(1) the treaty creates a legal relationship between the host State and the investor. The latter is then the holder of substantive rights and may resort to the remedies available under the treaty;

⁴⁵ *Avena and Other Mexican Nationals* (Mexico v. United States), Judgment, *I. C. J. Reports* 2004, p. 12, para 40.

⁴⁶ According to the UN International Law Commission (ILC) “[t]he individual is the subject of many primary rules of international law, both under custom and treaty, which protect him at home, against his own Government, and abroad, against foreign Governments. [...] This protection is not limited to personal rights. Bilateral investment treaties confer rights and protection on both legal and natural persons in respect of their property rights”, Commentary to Article 1 of the Draft Articles, para 4, at http://untreaty.un.org/ilc/texts/instruments/english/commentaries/9_8_2006.pdf. The ILC further pointed out that, “[d]raft article 1 is formulated in such a way as to leave open the question whether the State exercising diplomatic protection does so in its own right or that of its nationals – or both. It views diplomatic protection through the prism of State responsibility and emphasizes that it is a procedure for securing the responsibility of the State for injury to the national flowing from an internationally wrongful act”.

(2) the substantive rules continue to apply exclusively between the Parties, but the related procedural rights in case of disputes are granted to and can be exercised directly by the concerned foreign investor.⁴⁷

Both alternatives elucidate the real nature of BITs and ultimately lead to the same result.⁴⁸ The first alternative, nonetheless, is to be preferred as it realistically describes investment arbitration as “a remedy exercisable by an investor by itself and in its own right against the host state”.⁴⁹ In a recent case, a tribunal held that

in the case of Chapter XI of the NAFTA [...] the intention of the Parties was to confer substantive rights directly upon investors. That follows from the language used and is confirmed by the fact that Chapter XI confers procedural rights upon them. The notion that Chapter XI conferred upon investors a right, in their own name and for their own benefit, to institute proceedings to enforce rights which were not theirs but were solely the property of the State of their nationality is counterintuitive.⁵⁰

It must however be pointed out that under neither alternative referred to above the legal relationship between the States parties to the treaty is disposed of. In both cases, the treaty continues to impose upon the host State primary obligations owed to the other State. Under the first alternative described above, these obligations have an identical content to those owed to the investor, but remain quite independent from them. As such, they may be the object of an international claim in accordance with the relevant rules contained in the treaty. Under the second alternative, while the State remains the sole holder of the rights stemming from the treaty, alleged non-compliance with the corresponding obligations may bring about a dispute between the investor and the host State as well as between the States concerned.

Either way, international investment treaties provide for two different categories of disputes between different parties and before different tribunals. The same facts may generate two independent disputes – the first between the investor and the host State and

⁴⁷ Z. Douglas, ‘The Hybrid Foundations of Investment Treaty Arbitrations’, *British Year Book International Law* (2003) 151, especially p. 181-184.

⁴⁸ See also *Occidental Exploration and Production Company v. Republic of Ecuador*, LCIA Case No. UN3467, Judgment, 9 September 2005, para 18.

⁴⁹ *Plama v. Bulgaria*, above n. 40, para 150. See also *Occidental Exploration v. Ecuador*, above n. 48, paras 14 - 22.

⁵⁰ *Corn Products International, Inc. v. Mexico*, ICSID ARB (AF)/04/1 (NAFTA), Decision on Responsibility (redacted version), 15 January 2008, para 169.

the second between the States concerned.⁵¹ No question of *litispendens* would arise as the parties to the dispute are different. Consequently, the dispute between the foreign investor and the host State is not affected by the filing by the latter of a case against the home State. In *Empresas Lucchetti v. Peru*, the Respondent filed a request for suspension of the proceedings since the same allegations were the subject of a concurrent State-to-State arbitration. The Tribunal held that the conditions for a suspension of the proceedings were not met and rejected the request without any further discussion.⁵²

The dispute between the foreign investor and the host State is completely dissociated and independent from the conduct of the home State. This is confirmed by the fact that home States have occasionally taken position against the competence of investment tribunals to settle disputes between their own nationals and the host State,⁵³ or expressed disagreement on the merits with the position of their own nationals.⁵⁴

IV. States' regulatory powers and investors' legitimate expectations

International investment law is essentially concerned with the legal relationship between the host State and foreign investors. On the one hand, once admitted to invest in the territory of the host States, investors are subjected to and must comply with local laws and regulations. On the other hand, the host State is fully entitled to exercise its regulatory powers over foreign investors. The ultimate purpose of BITs is precisely to define how the host State must treat foreign investors. From this perspective, a delicate balance needs to be struck between the regulatory powers of the host State and the need to legally protect the interests of foreign investors.⁵⁵ While a full discussion on this balancing exercise, which is at the heart of foreign investment law, falls beyond the scope

⁵¹ In *Plama v. Bulgaria*, above n. 40, para 150, the Tribunal held that even if the investor cannot invoke Article 26 Energy Charter Treaty (settlement of disputes between investors and host State), it would leave intact its home state's right to invoke Article 27 Energy Charter Treaty against the host State.

⁵² *Empresas Lucchetti, S.A. and Lucchetti Peru, S.A. v. Peru*, ICSID ARB/03/4, Award, 7 February 2005, paras 7 and 9.

⁵³ See, for instance, United States Submission in *GAMI Investment Inc. v. Mexico*, available at <http://www.state.gov/documents/organization/22212.pdf>.

⁵⁴ See, for instance, Canada Second Submission in *Mondev v. United States*, 6 July 2001, available at <http://www.state.gov/documents/organization/18271.pdf>.

⁵⁵ India has argued before the WTO Working Group on Trade and Investment that "investment protection at present is guaranteed by a host of bilateral investment promotion and protection agreements (BIPPA) that countries have entered into with other countries. Many governments look upon these bilateral instruments as on the one hand giving policy flexibility for themselves while assuring foreign investors a degree of comfort and safety for their investments" (WT/WGTI/W/86, 22 June 2000, p. 3).

of this chapter, a couple of general considerations from the standpoint of BITs are in order.

By concluding a BIT the contracting parties accept some obligations – in addition to in addition to those stemming from customary international law and other applicable international treaties – in relation to the exercise of their sovereign rights in their dealings with foreign investors. As observed by a tribunal, according to ‘the basic international law principles [...] while a sovereign State possesses the inherent right to regulate its domestic affairs, the exercise of such right is not unlimited and must have its boundaries. ... [T]he rule of law, which includes treaty obligations, provides such boundaries’.⁵⁶ As long as these boundaries are respected, the host State has no duty to compensate foreign investors, even when the measures adopted have a negative economic impact on their business.⁵⁷ The principle is not affected by the fact that several provisions contained in BITs still remain fraught with legal uncertainty, as in the case of indirect expropriation.⁵⁸

Equally important, investment tribunals are not meant to review or assess the exercise of regulatory powers by the host State. Quite the contrary, their task is strictly limited to determine whether the host State has violated any of the limits imposed by the relevant

⁵⁶ *ADC Affiliate Limited and ADC & ADMC Management Limited v. Hungary*, ICSID ARB/03/16, Award, 2 October 2006, para 423.

⁵⁷ As emphasised in *Técnicas Medioambientales Tecmed, S.A. v. Mexico*, ICSID ARB (AF)/00/2, Award, 29 May 2003, para 119, ‘[t]he principle that the State’s exercise of its sovereign powers within the framework of its police power may cause economic damage to those subject to its powers as administrator without entitling them to any compensation whatsoever is undisputable’. See also *S.D. Myers v. Canada*, UNCITRAL (NAFTA), First Partial Award, 13 November 2000, para 285; *Methanex Corp. v. United States*, UNCITRAL (NAFTA), Final Award, 3 August 2005, Part IV, para 410; *Saluka Investments BV v. Czech Republic*, above n. 29, para 276.

⁵⁸ See, for instance, *Lauder v. Czech Republic*, UNCITRAL, Award, 3 September 2004, para 200; *Saluka Investments BV v. Czech Republic*, above n. 29, para 263. See also: A. Reinisch, ‘Expropriation’, Report submitted to the ILA, at www.ilahq.org/pdf/Foreign%20Investment/ILA%20paper%20Reinisch.pdf; W.M. Reisman, R.D. Sloane, ‘Indirect Expropriation and Its Valuation in the BIT Generation’, 74 BYIL (2004) 115; J. Paulsson, Z. Douglas, ‘Indirect Expropriation in Investment Treaty Arbitration’, in N. Horn, S. Kröll (eds.), *Arbitrating Foreign Investment Disputes* (The Hague: Kluwer, 2004), p. 145; L.Y. Fortier, S.L. Drymer, ‘Indirect Expropriation in the Law of International Investment: I Know It When I See It, or Caveat Investor’, *ICSID Review - FILJ* 19 (2004) 293; A. Newcombe, ‘The Boundaries of Regulatory Expropriation in International Law’, *ICSID Review - FILJ* 20 (2005) 1; S. Montt, *State Liability in Investment Treaty Arbitration* (Oxford: Hart, 2009), Chapter 5; T. Gazzini, Drawing the Line between Non-compensable Regulatory Powers and Indirect Expropriation of Foreign Investment, 7 *Manchester Jour. Int. Econ. Law* (2010) 36.

BIT. The finding of the Tribunal in *S.D. Myres v. Canada* in relation to Chapter XI NAFTA can certainly be extended to BITs. Accordingly, investment tribunals do not have

an open-ended mandate to second-guess government decision-making. Governments have to make many potentially controversial choices. In doing so, they may appear to have made mistakes, to have misjudged the facts, proceeded on the basis of a misguided economic or sociological theory, placed too much emphasis on some social values over others and adopted solutions that are ultimately ineffective or counterproductive. The ordinary remedy, if there were one, for errors in modern governments is through internal political and legal processes, including elections.⁵⁹

Some BITs further safeguard the regulatory powers of the parties by inserting three types of clauses. The first type of clause reaffirms and elaborates on the right of States to regulate in certain specific domains, such as the protection of the environment. They vary significantly. A good example can be found in Article VII (4) BIT between Belgium-Luxemburg Economic Union and Colombia, which reads:

[n]othing in this Agreement shall be construed as to prevent a Contracting Party from adopting, maintaining, or enforcing any measures that *it considers* appropriate to ensure that an investment activity in its territory is undertaken in accordance with environmental law of the Party.⁶⁰

Although these clauses are normally not covered by the provisions on investor-State or State-State disputes, they may offer important indication with regard to the balancing of public interest against the interests of foreign investors.

A second type of clause aims at preserving the right of States to adopt measures that are normally inconsistent with their international obligations, but nonetheless necessary to protect its fundamental interests.⁶¹ Article 2 (3) of the BIT between the Russian Federation and Hungary, for instance, provides that

⁵⁹ *S.D. Myers, Inc. v. Canada*, UNCITRAL (NAFTA), First Partial Award, 13 November 2000, para 261. See also *Gami Investments, Inc. v. Mexico*, UNCITRAL (NAFTA), Award, 15 November 2004, para 93.

⁶⁰ Emphasis added. See also Article 12 (1) of the United States model BIT, at <http://italaw.com/documents/USmodelbitnov04.pdf>, according to which the Parties recognize that it is inappropriate to encourage investment by weakening or reducing the protections afforded in domestic environmental laws.

⁶¹ A selection of these clauses can be found in K. Gordon, J. Pohl, above n. 23, p. 17-18.

[t]his Agreement shall not preclude the application of either Contracting Party of measures, necessary for the maintenance of defence, national security and public order, protection of the environment, morality and public health.

A third type of clause is a typical conflict clause. Article 7 (2) of the BIT between Canada and Peru, for instance, allows for the adoption of certain measures intended to protect the environment that otherwise would be contrary to treaty obligation, provided that they are non discriminatory. It reads:

[a] measure that requires an investment to use a technology to meet generally applicable health, safety or environmental requirements shall not be construed to be inconsistent with paragraph 1(f) [to transfer technology, a production process or other proprietary knowledge]. For greater certainty, Articles 3 [national treatment] and 4 [most-favoured-nation treatment] apply to the measure.

All these clauses may be considered by investment tribunal for the purpose of assessing the legitimate expectations of foreign investors. Yet, several investment tribunals have emphasized that in exercising its regulatory powers, the host State must respect the expectations that foreign investors may have legitimately built on the basis of promises, undertakings, declarations and representations made explicitly or implicitly by local authorities in relation to the establishment and management of the investment.

The notion of legitimate expectations affects virtually all instances in which foreign investors enter into contact with and are subject to the exercise of public authorities within the jurisdiction of the host State. In *Tecmed v Mexico*, for instance, the Tribunal considered the fair and equitable treatment (FET) standard and held that

[Article 4(1) BIT between Spain and Mexico], in light of the good faith principle established by international law, requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment. The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations.⁶²

⁶² *Técnicas Medioambientales Tecmed, S.A. v. Mexico*, ICSID ARB (AF)/00/2, Award, 29 May 2003, para 154. See also: Wälde, Separate Opinion in *International Thunderbird Gaming Corporation v. Mexico*, UNCITRAL (NAFTA), Award, 26 January 2006, esp. paras 27 ff.; *Rumeli Telekom A.S. and Telsim Mobil Telekomunikasyon Hizmetleri A.S. v. Kazakhstan*, ICSID ARB/05/16, Award, 29 July 2008, para 609. In literature, see, in particular R. Dolzer, 'New Foundations of the Law of Expropriation of Alien Property',

The finding, which has been quoted with approval by several tribunals⁶³, emphasises the need to protect the legitimate expectation of private investors in their dealing with the host State. Intimately related to the principle of good faith,⁶⁴ the principle of legitimate expectations has been borrowed from domestic administrative law. It has emerged within the different domestic legal systems for the purpose of protecting natural and legal person subjected to the authority of public bodies.⁶⁵

V. States *domini* of the treaties

While foreign investors are the main beneficiaries of BITs, State parties remain “the transaction’s exclusive and absolute *domini*”.⁶⁶ At any time they can agree on a given interpretation of, formally or informally modify, or even terminate the treaty, in accordance with the treaty itself or, when the treaty is silent on the specific issue, with the law on treaties. This means that foreign investors are exposed to the risk of a change in the legal protection they enjoy under the BIT in the host State due to the joint or

American Jour. Int. Law 75 (1981) 553; E. Snodgrass, ‘Protecting Investors’ Legitimate Expectations: Recognizing and Delimiting a General Principle’, *ICSID Review – FILJ* 21 (2006); S. Fietta, ‘The ‘Legitimate Expectations’ Principle under Article 1105 NAFTA. *International Thunderbird Gaming Corporation v. Mexico*’, *JWI&T* 7 (2006) 423; I. Tudor, *The Fair and Equitable Treatment Standard in International Foreign Investment Law* (Oxford: OUP, 2008), especially p. 163-168; K.J. Vandeveld, ‘A Unified Theory of Fair and Equitable Treatment’, *New York Univ. Jour. Int. Law and Politics* 43 (2010) 43.

⁶³ See, for instance, *MTD Equity Sdn. Bhd. & MTD Chile S.A. v. Chile*, ICSID ARB/01/7, Award, 25 May 2004, paras 114-115; *Eureko B.V. v. Poland*, Partial Award and Dissenting Opinion, 19 August 2005, para 235. As observed in *Saluka v. Czech Republic*, above n. 29, para 302, the standard of “fair and equitable treatment” is therefore closely tied to the notion of legitimate expectations which is the dominant element of that standard’.

⁶⁴ Already in 1983, the Tribunal in *Amco v. Indonesia*, Award on Jurisdiction, 25 September 1983, p. 359, p. 385, held that ‘any convention [...] should be construed in good faith, that is to say by taking into account the consequence of their commitments the parties may be considered as having reasonably and legitimately envisaged’.

⁶⁵ M. Sornarajah, *The International Law on Foreign Investment*, 3rd ed. (Cambridge: CUP, 2010), p. 358. See also B. Kingsbury, S. Schill, ‘Investor-State Arbitration as Governance: Fair and Equitable Treatment, Proportionality and the Emerging Global Administrative Law’, September 2009, at ssrn.com.

⁶⁶ The expression has been borrowed from G. Arangio-Ruiz, *The United Nations Declaration on Friendly Relations and the System of the Sources of International Law* (Alphen a/d Rijn: Sijthoff & Noordhoff, 1979), p. 284-285, esp. note 183.

unilateral action of the parties to the treaty. It is worth pointing out that they may lose the protection of a BIT due to the decision of their own national states to terminate it.

From the standpoint of the law of the treaties, the fact that the foreign investor is extraneous to the rule-making process leading to the conclusion, amendment and termination of the treaty calls for some important considerations.

In the first place, the parties to a BIT can at any time amend its content, either formally (i.e. through a protocol) or informally (through subsequent practice). For the purpose of interpreting and applying a provision in the settlement of a given dispute, nonetheless, the amendment cannot produce its effects retroactively, if the rights acquired under the treaty by the foreign investor are to be adequately protected within a stable and predictable legal framework. This makes it indispensable to determine whether the amendment has taken place *at the time* of the conduct allegedly inconsistent with the BIT.

As pointed out by the *Enron* and *Sempra* tribunals with regard to the alleged self-judging character of Article XI of the BIT between Argentina and the United States,

[e]ven if [the self-judging] interpretation were shared today by both parties to the Treaty, it would still not result in a change of its terms. States are of course free to amend the Treaty by consenting to another text, but this would not affect rights acquired under the Treaty by investors or other beneficiaries.⁶⁷

It cannot be denied, however, that in practice it may be rather difficult to distinguish amendments, which alter the rights and obligations of the parties to the treaties, from interpretations, which on the contrary confirms or defines their content. This has been demonstrated by the controversial interpretation of Article 1105 NAFTA given in 2001 by the Free Trade Commission.⁶⁸

⁶⁷ *Enron Corporation and Ponderosa Assets, L.P. v. Argentina*, ICSID ARB/01/3, Award, 22 May 2007, para 337; *Sempra Energy International v. Argentina*, ICSID ARB/02/16, Award, 28 September 2007, para 385. The statement would have been clearer had it specified in the first sentence that no change would have resulted “for the purpose of this dispute”. As observed by B.C. Clagett, ‘Expropriation Issue before the Iran-United States Claims Tribunal: Is Just Compensation Required by International Law or Not’, *Law & Pol’y Int’l Bus.* 16 (1984): 813, p. 823, “[c]ustomary international law has long regarded such elementary principle as respect for lawfully acquired rights and respect for lawfully concluded agreements (*pacta sunt servanda*) as the cornerstones of relations between States and alien investors”.

⁶⁸ NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter 11 Provisions, July 31, 2001, at http://www.naftaclaims.com/files/NAFTA_Comm_1105_Transparency.pdf. For a sharp critique of the Commission interpretation, see Second Opinion of Professor R. Jennings, in *Methanex Corporation v United States*, UNCITRAL (NAFTA), at http://www.naftaclaims.com/disputes_us_methanex.htm. As pointed out by I. Sinclair, *The Vienna Convention on the Law of Treaties*, 2nd ed. (Manchester: MUP,

Additionally, States may also react to what they perceive as an inaccurate interpretation or application of BITs and clarify their intention by adopting unilateral statements or agreeing on joint legal instruments. In *Société Générale v. Pakistan*, for instance, Switzerland submitted a declaration expressing concern over the narrow interpretation given by the arbitral tribunal to the meaning of the so-called umbrella contained in the relevant BIT.⁶⁹ Similarly, several States, concerned about the uncertainty which characterises the interpretation of MFN treatment clauses and arguably in reaction to the *Maffezini v. Spain* decision on jurisdiction,⁷⁰ have availed themselves of different techniques to dissipate any possible doubt concerning their common intention.⁷¹

Finally, since investments are normally long-term operations, it is necessary to ensure that the protection guaranteed under BITs is sufficiently stable, while preserving the right of States to denounce these treaties. This is obtained through peculiar clauses contained in virtually all BITs that allow both parties to terminate the treaty, either at the end of the initial or any subsequent period of validity, or any time in the case of unlimited duration

1984), p. 138, “[i]t is inevitably difficult, if not impossible, to fix the dividing line between interpretation properly so called and modification effected under the pretext of interpretation”. See also: J-P. Cot, ‘La conduite subséquente des parties à un traité’, *Revue générale droit international public* 70 (1966) 633; M.K. Yasseen, ‘L’interprétation des traités d’après la Convention de Vienne sur le droit des traités’, *Recueil des cours* 151 (1976-III) 1, Chapter IV; F. Capotorti, ‘Sul valore della prassi applicativa dei trattati secondo la Convenzione di Vienna’, in *Il diritto internazionale al tempo della sua codificazione*, Studi Ago (Milano: Giuffrè, 1987), vol. I, p. 197; H. Thirlway, ‘The Law and Procedure of the International Court of Justice. 1960-1989 (Part Three)’, *British Year Book International Law* 62 (1991) 1, p. 48 ff.

⁶⁹ Note on the Interpretation of Article 11 of the Bilateral Investment Treaty Between Switzerland and Pakistan, attached to the Letter of the Swiss Secretariat for Economic Affairs to the ICSID Deputy-Secretary General, 1 October 2003, in *Mealey’s International Arbitration Reports*, February 2004.

⁷⁰ *Maffezini v. Spain*, above n. 18.

⁷¹ *Ad art. 4, al. (2) of the Protocol of the BIT recently concluded between Switzerland and Colombia*, for instance, reads in part: “[f]or greater certainty, it is further understood that the MFN treatment [...] does not encompass mechanisms for the settlement of investment disputes provided for in other international agreements concluded by the Party concerned”, available at <http://www.admin.ch/ch/f/ff/2006/8081.pdf>. See, also Article 5 (2) of the BIT concluded between Switzerland and Serbia Montenegro, 7 December 2007, at <http://admin.ch/ch/frs/i9/0.975.268.2.fr.pdf>; Annex 804.1 of the FTA between Canada and Peru, available at http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/Canada-PeruFTA_chapter8-en.pdf. Article 4 (3) of the 2007 Norway Model BIT, in turn, reads: “For greater clarity, treatment referred to in paragraph (1) does not encompass dispute resolution mechanism provided for in this agreement or other International Agreements”.

or extension. As a rule, the right to terminate the treaty must be exercised in accordance with the notice period requirement, which is normally of six or twelve months.

What makes BITs unique from the point of view of their termination is the systematic inclusion of a provision according to which they continue to produce their effects after the date of termination in respect of the investment made before such date. Examples of this clause can be found in numerous BITs, including BITs concluded between developing countries.⁷² The period is normally 10 or 15 years, and occasionally 5 or 20 years.

VI. Interpretation of BITs

Numerous tribunals have held that investment treaties must be interpreted in accordance with the rules of interpretation contained in the VCLT, which reflect customary international law⁷³. The applicability of these rules has rarely been challenged by the parties to investment disputes. When this occurred, tribunals discarded the argument. In *RosInvestCo UK Ltd v. Russian Federation*, in particular, the Tribunal rejected the Claimant's argument that these rules are no more than a convenient point of reference and firmly held that the application of these rules is a matter of legal obligation.⁷⁴

Only exceptionally have tribunals neglected the VCLT. In *Inceysa Vallisoletana S.L. v. El Salvador*, for instance, the Tribunal began the interpretation of the relevant BIT by examining the *travaux préparatoires* and then looked at its terms. Although the *travaux préparatoires* and the literal arguments pointed to the same direction and led to what the Tribunal considered as the only correct interpretation, the approach of the Tribunal

⁷² See, for instance, Egypt – India, Article 15 (2); Lebanon – Malaysia, Article 12 (4). See also India Model Treaty, Article 15 (2).

⁷³ See, for instance, *Saluka v. Czech Republic*, above n. 29, para 296; *Mondev International Ltd. v. United States*, ICSID ARB(AF)/99/2 (NAFTA), Award, 11 October 2002, para. 43; *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Jordan*, ICSID ARB/02/13, Jurisdiction, 9 November 2004, para 75; *Plama v. Bulgaria*, above n. 40, para 117; *Methanex Corp. v. United States*, above n. 57, Part II, Chapter B, para 15; *Malaysian Historical Salvors, SDN, BHD v. Malaysia*, ICSID ARB/05/10, Annulment, 16 April 2009, para 56. It has also been pointed out that interpretation of investment treaties calls for a “particular duty of caution” as one of the parties to the disputes was a stranger to the treaty negotiation, Berman, dissenting opinion in *Industria Nacional de Alimentos, S.A. and Indalsa Perú, S.A. v. Peru*, ICSID ARB/03/4, Decision on Annulment, 5 September 2007, para 9.

⁷⁴ Para 38.

remains questionable.⁷⁵ The logical sequence established in Article 31 VCLT, which has its natural point of departure in the literal analysis of the text, must be carefully respected by tribunals and departures may lead to misinterpretations of the relevant provisions and ultimately distortions of the intention of the contracting parties.

After some hesitation, investment tribunals have definitely accepted that BITs must be interpreted in a balanced and unbiased manner as required by Article 31 VCLT. In this regard, in *Mondev v. United States*, the Tribunal unambiguously rejected that these treaties call for an interpretation favourable to the host State or the foreign investor.⁷⁶ Another Tribunal confirmed that

a balanced interpretation is needed, taking into account both State sovereignty and the State's responsibility to create an adapted and evolutionary framework for the development of economic activities, and the necessity to protect foreign investment and its continuing flow.
⁷⁷

Some doubts have been expressed in literature not about the applicability of the VCLT but rather about its adequacy to solve interpretative questions of investment treaties. It has been argued that the VCLT "is only of limited use in giving guidance to a tribunal in its interpretative task. Problems arise because the VCLT's rules of construction are capable of supporting a wide range of potential interpretations"⁷⁸.

It is certainly true that Articles 31 to 33 VCLT have not satisfactorily settled all questions related to interpretation⁷⁹ and that they do not ensure an irrefutable interpretation in every case.⁸⁰ This is self-evident when the provision to be interpreted has been drafted – intentionally or not – in ambiguous or vague terms.

⁷⁵ *Inceysa Vallisoletana S.L. v. El Salvador*, ICSID ARB/03/26, Award, 2 August 2006, paras 190 to 203. The Tribunal finally held that the interpretation was confirmed by 'a harmonious interpretation' based on contextual considerations.

⁷⁶ *Mondev v. United States*, above n. 19, para 43 (footnote omitted).

⁷⁷ *El Paso Energy v. Argentina*, Case ARB/03/15, Jurisdiction, 27 April 2006, para 70. In *AMCO v. Indonesia*, 25 September 1983, 89 *ILR* (1992) 379, p. 384-5, the Tribunal held that "a convention to arbitrate is not to be construed *restrictively*, nor, as a matter of fact, *broadly* or *liberally*. It is to be construed in a way which leads to find out and to respect the common will of the parties: such a method is but the application of the fundamental principle *pacta sunt servanda*".

⁷⁸ C. McLachlan, L. Shore, M. Weiniger, above n. 16, p. 67.

⁷⁹ For a balanced and thoughtful critical analysis, see M. Fitzmaurice, 'Dynamic (Evolutive) Interpretation', 21 *Hague Yearbook of International Law* (2008): 101.

⁸⁰ R. Gardiner, *Treaty Interpretation* (Oxford: Oxford University Press, 2008), p. 9.

However, the relevant provisions of the VCLT are a well formulated compromise⁸¹ and Article 31 in particular contains a single rule combining different elements.⁸² An ICSID Tribunal has aptly observed that

[i]nterpretation under Article 31 of the Vienna Convention is a process of progressive encirclement where the interpreter starts under the general rule with (1) the ordinary meaning of the terms of the treaty, (2) in their context and (3) in light of the treaty's object and purpose, and by cycling through this three step inquiry iteratively closes in upon the proper interpretation.⁸³

It may be argued that the main shortcoming of Article 31 VCLT lies in the fact that it presupposes the harmony of its different elements in the sense that it assumes that is possible to find an interpretation based on literal and contextual considerations and consistent with the object and purpose of the treaty as well as with other rules of international law applicable between the parties. It offers little guidance to the interpreter as to how to deal with situations in which the different elements the interpreter must take into account are conducive to different interpretations.

Investment treaties are not immune from this problem as epitomised by the interpretation of Article 1 (2) (b) of the BIT between Lithuania and Ukraine, concerning the nationality of legal persons, in *Tokios Tokelés v. Ukraine*. The majority of the Tribunal stuck to a literal interpretation of the provision on the nationality of legal persons and found that the only relevant consideration was whether the Claimant was established under the laws of Lithuania, regardless to the fact that Ukrainian subjects held 99 % of the company shares.⁸⁴ In a strongly worded dissenting opinion, the president of the Tribunal argued that the object and purpose of the whole ICSID system being the protection of *foreign*

⁸¹ T.W. Walde, 'Interpreting Investment Treaties: Experiences and Examples', in C. Binder *et al*, *International Investment Law for the 21st Century. Essays in Honour of C. Schreuer* (Oxford: Oxford University Press, 2009): 724, at 746

⁸² See *Yearbook International Law Commission* 18 (1966-II), pp. 219-220. The Commission further noted that Article 31 'is entitled 'General rule of interpretation' in the singular, not 'General rules' in the plural, because the Commission desired to emphasize that the process of interpretation is a unity and that the provisions of the article form a single, closely integrated rule'.

⁸³ *Agua del Tunari S.A. v. Bolivia*, ICSID ARB/02/3, Decision on Respondent's Objections to Jurisdiction, 21 October 2005, para 91. As pointed out by the WTO Appellate Body in *EC – Customs Classification of Frozen Boneless Chicken Cuts*, WT/DS269/AB/R, 12 September 2005, para 176, interpretation is a "holistic exercise that should not be mechanically subdivided into rigid components". See also I. Sinclair, *The Vienna Convention on the Law of Treaties*, 2nd ed. (Manchester: MUP, 1984), p. 153.

⁸⁴ *Tokios Tokelés v. Ukraine*, ICSID ARB/02/18, Jurisdiction, 29 April 2004, para 38.

investment, the control over the company is crucial and may prevail over the formal criteria indicated in the treaty.⁸⁵

With regard to the interaction between BITs and other rules of international law, two questions must be briefly addressed. On the one hand, BITs cannot be interpreted “in isolation from public international law”.⁸⁶ Under Article 31 (3) (c) VCLT, the interpreter has to take into account “any relevant rule of international law applicable in the relation between the parties”. Article 31 (3) (c) has a huge potential in respect to the interpretation of BITs as the controversial question that has accompanied systemic interpretation - namely whether the relevant rules referred to must be applicable to the parties to the dispute or to the parties to the relevant treaty - does not arise in the context of BITs due to the bilateral character of these treaties.

While the relevance of Article 31 (3) (c) is generally accepted in investment arbitration,⁸⁷ it remains that the expression “to take into account” remains rather vague and could mean almost anything. The interpreter is then called to rigorously keep the distinction between applicable law and systemic interpretation. From this perspective, a tribunal has aptly held that

Applicable in the relations between the parties’ must be taken as a reference to rules of international law that condition the performance of the specific rights and obligations stipulated in the treaty – or else it would amount to a general licence to override the treaty terms that would be quite incompatible with the general spirit of the Vienna Convention as a whole.⁸⁸

On the other hand, in a few cases investment tribunals have taken into account, for the purpose of interpreting the BIT before them, other BITs concluded by one party – normally the Respondent – or both parties with third States.⁸⁹ Given the *res inter alios acta* character of treaties, reliance on these treaties must be treated with the greatest

⁸⁵ Dissenting opinion P. Weil, especially paras 19 ff. Subsequent tribunals have adopted the view of the majority in *Tokios Tokelés v. Ukraine*, see, C. Schreuer, with L. Malintoppi, A. Reinisch, A. Sinclair, *The ICSID Convention: A Commentary*, 2nd ed. (Cambridge: CUP, 2009), p. 290-292.

⁸⁶ *Phoenix Action, Ltd. v. Czech Republic*, ICSID ARB/06/5, Award, 15 April 2009, para 78.

⁸⁷ See, for instance, *Saluka Investments BV (The Netherlands) v. Czech Republic*, Partial Award, UNCITRAL, 17 March 2006, para 254.

⁸⁸ *RosInvestCo UK Ltd. v. Russian Federation*, SCC Arb. V079/2005, Jurisdiction, October 2007, para 39.

⁸⁹ See, for instance, *Maffezini v. Spain*, above n. 18, especially paras 57-61, taking into account only the practice of the Respondent; *Aguas del Tunari S.A. v. Bolivia*, above n. 83, especially paras 289-314, comparing the practice of both concerned States.

prudence⁹⁰ and can at best be an “aid to interpretation”,⁹¹ certainly not a canon or a rule of interpretation.⁹²

In *Wintershall v. Argentina*, the Tribunal correctly refused to consider treaties concluded between the Respondent and third states for the purpose of interpreting the BIT the claimant had based its claim upon.⁹³ Indeed, the practice related to conclusion of BITs with third States does not amount to the subsequent practice of the parties *in the application of the treaty* for the purpose of Article 31 (3) (b) VCLT, nor does it fall into any of the elements expressly provided for in Article 31 VCLT. In spite of the silence of the VCLT, nevertheless, it may be argued that these treaties could be taken into consideration to elucidate a term or a provision contained in the BIT to be interpreted, but exclusively to the extent they show a clear and consistent pattern in the practice of *both* parties. Needless to say, such a technique might be impracticable when the concerned States have ratified a large number of BITs.

VII. Settlement of disputes

Whereas a full treatment of the settlement of disputes related to the interpretation and application of BITs falls beyond the purpose of this chapter, a few basic considerations in this respect are in order. Traditionally, foreign investors could rely only on the domestic courts of the host State and on diplomatic protection. For different reasons, neither remedy offered in the past or offers today an adequate and reliable protection. On the one hand, domestic tribunals do not always deliver their decisions effectively and

⁹⁰ In *AES Corporation v. Argentina*, ICSID ARB/02/17, Jurisdiction, 26 April 2005, paras 24-25, the Tribunal pointed out that ‘each BIT has its own identity; its very terms should consequently be carefully analyzed for determining the exact scope of consent expressed by its two Parties. This is in particular the case if one considers that striking similarities in the wording of many BITs often dissimulate real differences in the definition of some key concepts, as it may be the case, in particular, for the determination of “investments” or for the precise definition of rights and obligations for each party’.

⁹¹ In *L.E.S.I. S.p.A. et ASTALDI S.p.A. v. Algeria*, ICSID ARB/05/3, Decision, 12 July 2006, para 84 (ii), the Tribunal found in another BIT the confirmation *a contrario* of the interpretation reached on the basis of Article 31 VCLT.

⁹² See, H. Thirlway, ‘The Law and Procedure of the International Court of Justice 1960-1989. Part Three’, *BYIL* 62 (1991):1 p. 66. In the 2006 Supplement, *BYIL* 77 (2006) 1, p. 74, however, the same author takes a more nuanced position.

⁹³ *Wintershall Aktiengesellschaft v. Argentina*, ICSID ARB/04/14, Award, 8 December 2008, para 128.

independently;⁹⁴ on the other hand, diplomatic protection depends on a political initiative by the government concerned and is exposed to the risk of politically motivated decisions.

To overcome this unsatisfactory situation, virtually all modern BITs contain provisions on the settlement of disputes between the States parties as well as between one of them and the investors of the other. The first category of disputes, can be settled either through mediation or negotiation, or by resorting to international tribunals. Investment related arbitration between States, however, remains quite exceptional.⁹⁵

As noted above, investment treaties typically provide also for the settlement of disputes between the host State and foreign investors.⁹⁶ Like State-State disputes, these disputes can be settled through negotiations, mediation, consultations or conciliation.⁹⁷ If a friendly settlement cannot be reached, the dispute may be settled before arbitral tribunals modelled after international commercial arbitration.⁹⁸ The importance of access to investment arbitral tribunals has been emphasised by numerous tribunals. One of them pointed out that

[t]he creation of ICSID and the adoption of bilateral investment treaties offered to investors assurances that disputes that might flow from their investments would not be subject to the perceived hazards of delays and political pressures of adjudication in national courts. Correspondingly, the prospect of international arbitration was designed to offer to host states freedom from political pressures by governments of the state of which the investor is a national.⁹⁹

⁹⁴ On the difficulties surrounding the assessment of the independence of domestic tribunals, see, for instance, *Aguinda v. Texaco, Inc.*, 142 F.Supp.2d 534 (S.D.N.Y. 2001); *Chevron Corporation v. S. Donziger*, 2011 WL 778052 (S.D.N.Y. 2011).

⁹⁵ For one of the rare examples of investment disputes between States, see *Italian Republic v. Republic of Cuba*, *ad hoc* arbitration, Final Award, 15 July 2008.

⁹⁶ For two examples of BITs silent on the settlement of disputes between foreign investor and a party to the treaty, see the BITs between Switzerland and Morocco, and between Bulgaria and Cyprus.

⁹⁷ For a BIT providing for conciliation, see Article 9 (2) of the BIT between India and the United Kingdom.

⁹⁸ On the importance of negotiations and mediation, see, in particular, T. Wälde, 'Effective Management of Transnational Disputes: Mutual Gain by Mediation or Joint Loss in Litigation', *Arbitration International* 22 (2006): 205.

⁹⁹ *Gas Natural SDG v Argentina*, ICSID ARB/03/10, Jurisdiction, 17 June 2005, paras 29 ff (notes omitted).

Provisions on the settlement of investor-State disputes may vary significantly with regard to their scope of application, the choice of the arbitral tribunal, the applicable law and any other procedural matters. They normally contain a standing offer that is unconditionally made by the host State and expresses the State's consent to settle before investment tribunals any dispute or certain categories of disputes that may arise with foreign investors of the other party. The consent of the host State matches that of the foreign investor the moment the latter files a request for arbitration or accepts in writing the competence of the arbitral tribunal.¹⁰⁰ Some BITs identify the arbitral tribunal competent to settle the dispute between foreign investors and the host State,¹⁰¹ while others leave foreign investors and possibly the host State the choice between two or more investment arbitral proceedings.¹⁰²

The requirement to exhaust them before resorting to international arbitration, which was rather rare in old BITs, has almost completely disappeared in modern BITs,¹⁰³ a development in line with Article 26 ICSID and the jurisprudence of investment tribunals outside ICSID.¹⁰⁴ Although abandoned as procedural requirement, the exhaustion of domestic remedies may nonetheless still apply as substantive standard with regard to

¹⁰⁰ J. Paulsson, 'Arbitration without Privity', *ICSID Review/FILJ* 10 (1995): 232; C. Schreuer, 'Consent to Arbitration', in P. Muchlinski, F. Ortino, C. Schreuer (eds.), *The Oxford Handbook of International Investment Law* (Oxford: OUP, 2008), p. 830

¹⁰¹ See, for instance, Article 8 BIT between the United Kingdom and the United Arab Emirates.

¹⁰² See, for instance, Article VI (2) BIT between the United States and Estonia; Article 9 (3) BIT between United Kingdom and India; Article 8 (5) BIT between Italy and Argentina; Article 8 (3) BIT between Pakistan and Egypt.

¹⁰³ C. Schreuer, 'Travelling the BIT Route – Of Waiting Periods, Umbrella Clauses and Forks in the Road', *Journal of World Investment & Trade* 5 (2004): 231; *Id.*, 'Calvo's Grandchildren: The Return of Local Remedies in Investment Arbitration', *Law and Practice of International Courts and Tribunals* 1 (2005): 1.

¹⁰⁴ See, for instance, within NAFTA, *Loewen Group, Inc. and Raymond L. Loewen v. United States*, ICSID ARB(AF)/98/3 (NAFTA), Merits, 26 June 2003, para 1424 ff.; and within ASEAN, *Yaung Chi Oo Trading PTE Ltd. v. Government of the Union of Myanmar* ASEAN ICSID Case No. ARB/01/1, Final Award, 31 March 2003, para 40.

certain categories of claims based on BITs, namely indirect expropriation¹⁰⁵ and denial of justice,¹⁰⁶ due to the intrinsic nature of the alleged breaches.

Three types of clauses often deal with the co-ordination between proceedings before domestic courts and arbitral tribunals. Several BITs contain a co-called fork in the road provision, according to which the applicant must make a final choice between bringing the case before national courts or before investment tribunals. The wording of these provisions may vary and normally is sufficiently clear.¹⁰⁷ Their functioning is limited to cases in which the applicant is seeking to institute proceedings before a domestic court and an investment tribunal in relation to the same dispute involving the same parties and the same cause of action.¹⁰⁸

A second type of clause contains a waiver, as does Article 26 (2) of the United States Model Treaty.¹⁰⁹ Unlike fork in the road clauses, these clauses require foreign investor to waive, at the time they bring a dispute before an investment arbitral tribunal, all other claims related to the same conduct or measures adopted by the host State. These clauses not only prevent parallel proceedings, but also offer to foreign investors the possibility to have their claims adjudicated first by national tribunals and then, if necessary, by investment arbitral tribunals, and to the host State the opportunity to judicially redress the wrongdoing, if any.¹¹⁰

¹⁰⁵ In *Generation Ukraine, Inc. v. Ukraine*, ICSID ARB/00/9, Final Award, 16 September 2003, para 20.30, the Tribunal referred to “a reasonable – not necessarily exhaustive – effort by the investor to obtain correction” before domestic courts.

¹⁰⁶ *Chevron Corporation (USA) and Texaco Petroleum Company (USA) v. Ecuador*, UNCITRAL, PCA Case No. 34877, Interim Award, 1 December 2008, para 235.

¹⁰⁷ Compare, for instance, Article VI (2) BIT between the United States and Ecuador; Article 8 (2) BIT between France and Argentina; Article VIII (2) BIT between Indonesia and Zimbabwe; Article 13 (1) BIT between Argentina and Australia; Article VI (2) BIT between the United State and Estonia.

¹⁰⁸ C. Schreuer, with L. Malintoppi, A. Reinisch, A. Sinclair, above note 85, p. 365 ff.

¹⁰⁹ For another example, see Article 9 (2) BIT between Greece and Mexico, under which “[i]f an investor submits a claim to arbitration [...], neither he or his investment that is a legal person may initiate or continue proceedings before a national tribunal, except for proceedings for injunctive, declaratory or other extraordinary relief, nor involving the payment of damages, before an administrative tribunal or court under the law of the disputing Contracting Party”. See also Article 12 (3) of the BIT between Iran and South Africa, according to which “National courts shall not have jurisdiction over any dispute referred to arbitration”.

¹¹⁰ See on this point C. McLachlan, L. Shore, M. Weiniger, above n. 16, p. 107-109. See also *Waste Management, Inc. v. Mexico*, ICSID ARB(AF)/98/2 (NAFTA), Jurisdiction, 2 June 2000.

A third type of clause imposes upon the applicant a waiting period during which litigation must be pursued before domestic courts before resorting to investment tribunals.¹¹¹ The period may be as long as 18 months¹¹² and has been described by a tribunal as “nonsensical for a practical point of view”.¹¹³ While the number of BITs containing such a clause remains limited, foreign investors are often able to dodge it by invoking MFN treatment.

VIII. BITs and contracts

BITs and contracts are different legal instruments concluded between different parties and possessing different legal nature. The rights and obligations they contain are entirely independent, are governed by the respective applicable laws, and subject to their respective jurisdictional clauses.

Yet, a conduct or measure may amount to a violation of either or both the BIT and the contract. The claim(s) that may arise must be settled in accordance with the relevant jurisdictional clause(s).¹¹⁴ As pointed out by the *ad hoc* Committee in *Vivendi I*,

[w]hether there has been a breach of the BIT and whether there has been a breach of the contract are different questions. Each of these claims will be determined by reference to its own proper or applicable law – in the case of the BIT, by international law; in the case of the Concession Contract, by the proper law of the contract [...].¹¹⁵

As long as a tribunal has been seized on the basis of the BIT, its competence is confined to determine whether a breach of the BIT has occurred and, if appropriate, to indicate the

¹¹¹ See C. Schreuer, above n. 85.

¹¹² See, for instance Article 10 (2) BIT between Germany and Argentina ; Article 8 (3) BIT between Italy and Argentina. Under Article VII (2) BIT between Turkey and Pakistan, a dispute may be submitted before an arbitral tribunal if the investor concerned has brought it before the domestic courts of the host State and a final award has not been rendered within one year”.

¹¹³ *Plama v. Bulgaria*, above n. 40, para 224.

¹¹⁴ *Compañía de Aguas del Aconquija S.A. and Vivendi Universal v. Argentina*, ICSID ARB/97/3, Annulment, 3 July 2002, para 95 (*Vivendi I*). In *SGS Société Générale de Surveillance S.A. v. Pakistan*, ICSID ARB/01/13, Jurisdiction, 6 August 2003, para 147, the Tribunal held that “the same set of facts can give rise to different claims grounded on different legal orders: the municipal and the international legal orders”, para 147. See also *Impregilo S.p.A. v. Pakistan*, ICSID ARB/03/3, Jurisdiction, 22 April 2005, para 258; *Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Pakistan*, ICSID ARB/03/29, Jurisdiction, 14 November 2005, para 160; *Compañía de Aguas del Aconquija S.A. and Vivendi Universal v. Argentina*, ICSID ARB/97/3, Award, 20 August 2007, 7.3.10 (*Vivendi II*).

¹¹⁵ *Vivendi I*, para 96, *Vivendi II*, para 7.3.10.

consequences of such a breach. For the purpose of the proceedings before the tribunal, it is irrelevant whether the act allegedly contrary to the BIT also amounts to a breach of a contract.¹¹⁶

Nonetheless, a tribunal is entitled, if not even obliged, to interpret the contract to the extent this is indispensable to establish whether any violation of the BIT has been committed. This was clearly held in *Vivendi I* and *Vivendi II*. In the latter case, the Tribunal held that it was allowed

to consider such alleged contractual breaches not for the purpose of determining whether a party has incurred liability under domestic law, but to the extent necessary to analyze and determine whether there has been a breach of the Treaty.¹¹⁷

Besides, States may commit themselves by treaty to comply with contractual obligations. Failure to comply with this commitment would amount to a breach of the treaty. Although “responsibility for breach of treaty is conceptually distinct from responsibility for breach of contract [...] the latter may, depending on the context, entail or imply the former”¹¹⁸.

If the treaty, interpreted in accordance with the rules on interpretation contained in the VCLT so provide, therefore, a treaty-based investment tribunal may exercise its jurisdiction in respect of contractual claims. This may occur, in the first place, on the basis of sufficiently wide jurisdictional clauses which confer the tribunal competence, for instance, for “disputes regarding investments”,¹¹⁹ “dispute with respect to investments”,¹²⁰ or “any dispute arising”¹²¹ between a Contracting Party and the investor of the other Contracting Party.

On this point, it has been observed that

¹¹⁶ *Eureko B.V. v. Poland*, UNCITRAL, Partial Award, 19 August 2005, para 112.

¹¹⁷ Para 7.3.10.

¹¹⁸ J. Crawford, ‘Treaty and Contract Investment Arbitration’, *Treaty and Contract in Investment Arbitration*, *Arbitration International* 24 (2008): 341, p. 357-358.

¹¹⁹ Article 7 BIT between Italy and Lebanon. Article 8 BIT between France and Argentina reads in the relevant part “tout différend relatif aux investissements”.

¹²⁰ Article 9 (1) BIT between China and Switzerland.

¹²¹ Article 9 (1) BIT between Italy and Pakistan.

when a BIT provides for investor/State arbitration in respect of all investment disputes rather than dispute concerning violations of the BIT, the tribunal is competent even for pure contract claims¹²².

Not all contractual obligations can be brought before a treaty based investment tribunal. It must be stressed that the obligation must be related to the investment. An ordinary contract, such as a contract for the supply of goods, does not fall within the competence of the tribunal.¹²³

Additionally, the contract must in principle be attributable to the State itself and not to State entities possessing independent legal personality, unless the treaty provides otherwise. It may further be argued that nothing prevent contracting parties from committing themselves to respect, as a matter of treaty law, contracts concluded between these entities.

Claims based on contracts can also reach a treaty-based investment tribunal through so-called umbrella clauses. These clauses are inserted in several BITs and typically guarantee that each Contracting Party shall observe any obligation it owns to foreign investments.¹²⁴ Since both the wording and the scope of application of these clauses may vary, a carefully interpretation of umbrella clauses on an individual basis is required.

After decades of oblivion, these clauses made a boisterous appearance in ICSID arbitration at the end of 2003. The decisions that followed have not always been consistent and jurisprudence remains unsettled. The interpretation and application of these clauses, as well as the construction of the underlying rights will be discussed in

¹²² C. Schreuer, 'Investment Treaty Arbitration and Jurisdiction over Contract Claims – the *Vivendi I* Case Considered', in T. Weiler (ed.), *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law* (London: Cameron, 2005) p. 281. In ICSID jurisprudence, see, for instance, *SGS Société Générale de Surveillance S.A. v. Philippines*, ICSID ARB/02/6, Jurisdiction, 29 January 2004, para 131. See also S. Alexandrov, 'Breach of Treaty Claims and Breach of Contract Claims: Is it Still Unknown Territory?', in K. Yannaca-Small (ed.), *Arbitration under International Investment Agreements: a Guide to the Key Issues* (Oxford: OUP, 2010) p. 323.

¹²³ See, for instance, *CMS Gas Transmission Company and Argentina*, ICSID Case ARB/01/8, Award, 12 May 2005, para 299. See also J. Crawford, above n. 118, p. 362.

¹²⁴ In literature see C. Schreuer, 'Travelling the BIT Route. Of Waiting Period, Umbrella Clauses and Forks in the Road', *JWI&T* 5 (2004) 231; S.A. Alexandrov, 'Breaches of Contract and Breaches of Treaty. The Jurisdiction of Treaty-based Arbitration Tribunals to Decide of Contract Claims in *SGS v. Pakistan* and *SGS v. Philippines*', *JWI&T* 5 (2004) 555; T.W. Wälde, 'The "Umbrella" Clause in Investment Arbitration – A Comment on Original Intentions and Recent Cases', *Journal World Trade & Inv.* 6 (2005) 183.

detail in Chapter VII of this book. For the purpose of the present chapter, suffice it to note that despite several divergences both in jurisprudence and literature, there is ample agreement that umbrella clauses may cover contractual obligations – the extent of which remains undefined – that could be susceptible of adjudication before treaty-based international investment tribunals. This has been accepted by all tribunals, even those that have adopted a narrow interpretation of these clauses.¹²⁵ It remains to explain how this occurs. Two theoretical explanations have been put forward.

According to the first view, these clauses oblige the host State to comply with its contractual obligations lest committing a breach of the treaty which would unavoidably entail its international responsibility and trigger its jurisdictional remedies. Nonetheless, the nature of contractual obligations does not change and remain distinct from the obligations stemming from the treaty. As pointed out by the *ad hoc* Committee in *CMS v. Argentina*,

[t]he effect of the umbrella clause is not to transform the obligation which is relied on into something else; the content of the obligation is unaffected, as is its proper law. If this is so, it would appear that the *parties* to the obligation (i.e., the persons bound by it and entitled to rely on it) are likewise not changed by reason of the umbrella clause.¹²⁶

According to the second view, on the contrary, umbrella clauses transform breaches of the contract into violations of the treaty. In *L.E.S.I. v. Algeria*, the tribunal held that

¹²⁵ *SGS Société Générale de Surveillance S.A. v Pakistan*, Decision on Jurisdiction, 6 August 2003, *Joy Mining Machinery Ltd v Egypt*, ICSID ARB/03/11, Jurisdiction, 6 August 2004. The second tribunal seems to limit such a possibility to contract of a certain – yet undefined – magnitude (para 51).

¹²⁶ *CMS Gas Transmission Company v. Argentina*, ICSID ARB/01/8, Annulment Decision, 25 September 2007, para 95 (c). According to P. Mayer, ‘La neutralisation du pouvoir normative de l’Etat en matière de contrats d’Etat’, *Journal de droit international* 113 (1986) 5, p. 36-7, umbrella clauses “empêchent l’Etat de méconnaître ses engagements contractuels sous peine de violer le traité. Mais certains auteurs leur attachent une conséquence encore plus radicale: ils transformeraient les obligations contractuelles en obligations internationales. Cette position méconnaît qu’il existe deux rapports distincts et parallèles: le rapport inter partes, entre parties au contrat d’Etat, qui reste soumise à la *lex contractus*, et le rapport interétatique, qui relève du droit de gens. Que la violation par l’Etat de ses obligations nées du contrat constitue en même temps la violation du traité ne suffit pas à altérer la nature de l’un ou de l’autre”.

[c]es clauses ont pour effet de transformer les violations des engagements contractuels de l'Etat en violations de cette disposition du traité et, par là même, de donner compétence au tribunal arbitral mis en place en application du traité pour en connaître.¹²⁷

The debate is however largely academic and of limited practical relevance if it is accepted that under these clauses a treaty-based tribunal is entitled to adjudicate contractual claims. The crux of the matter remains to establish when a contractual obligation falls within the scope an umbrella clause. Again, given the textual differences of umbrella clauses, this must be determined on a case-by-case basis in accordance with the VCLT rules on interpretation.

IX. Concluding remarks

Bilateral investment treaties have played and continue to play a crucial role in the promotion of the rule of law and the development of a stable and predictable legal framework. They are not only there to stay, at least in the near future: they are also quite successful. Their success is due to several factors, including the following.

First, the great flexibility of a bilateral framework allows contracting parties to tailor and adapt treaty provisions in order to meet their own specific and evolving needs. From this perspective, while BITs remain manifestly unbalanced in favour of foreign investors, recent practice shows that some States are prepared to include in BITs provisions on the protection of the environment, thus addressing one of the main sources of criticism of BITs, alongside with the scarce attention paid to human rights and labour standards.

Second, from the standpoint of foreign investors, BITs contain attractive substantive provisions whose effects are amplified by the MFN and NT clauses. BITs have generated a largely coherent body of jurisprudence and had a significant impact on the evolution of customary international law. Yet, inconsistent decisions on BIT claims have been delivered in the past and several issues still remain fraught with uncertainty. The risk of inconsistent decisions, however, is not peculiar to a bilateral framework, but rather inherent in the sovereign character of arbitral tribunals.

¹²⁷ *Conorzio Groupement L.E.S.I. v. Algeria*, ICSID Case ARB/03/08, 10 January 2005, para 25 (ii). Here the Tribunal is paraphrasing P. Weil, 'Problèmes relatifs aux contrats passés entre un état et un particulier', *Recueil des cours* 128 (1969) p. 130. See also E. Gaillard, *Journal de droit international* (2005) 211.

Third, BITs provide for truly innovative provisions on the settlement of disputes. These provisions elevate foreign investors to full participants in international law through direct access to international investment tribunals. Such an access ensures to foreign investors an unprecedented level of legal protection and overcome the risks and hazards which are often associate to domestic remedies and diplomatic protection.

Fourth, by concluding BITs States certainly do not relinquish their regulatory powers: they merely accept to respect some further limits to their exercise in dealings with foreign investors of the other party. It will inevitably be for adjudicators to determine, in the light of the facts at issue, whether these limits have been breached.¹²⁸ Adjudicating often requires to strike a delicate balance between the right to the host State to regulate and the protection of foreign investors rights and legitimate expectations.

Considering that the conclusion of a multilateral treaty on investment still appears rather remote and without prejudice to the increasing importance of investment-related provisions in regional economic integration agreements, the real challenge today is how to increase the coherence and effectiveness of the current, largely bilateral legal framework. From this perspective, the potential of BITs is enormous and not fully exploited yet.

¹²⁸ See, with regard to indirect expropriation, L.Y. Fortier, 'Caveat Investor: The Meaning of Expropriation and the Protection Afforded Investors Under NAFTA', *News from ICSID* 20 (2003) p. 11.